

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

JOINT APPLICATION OF BARBOUR)	
MANOR DISPOSAL PLANT, INC. AND)	
BARBOUR MANOR UTILITIES, INC.)	CASE NO. 8933
FOR APPROVAL OF SALE AND TRANS-)	
FER OF ASSETS AND INCREASE IN)	
RATES)	

O R D E R

On November 8, 1983, Barbour Manor Disposal Plant, Inc., ("Barbour Disposal") and Barbour Manor Utilities, Inc., ("Barbour Manor") filed with the Commission a joint application requesting approval of the sale and transfer of the assets of Barbour Disposal to Barbour Manor and an increase in rates. On May 17, 1984, the application was amended to include the borrowing of funds required to purchase the assets. The proposed rates would increase annual revenues by \$18,651 annually over reported 1982 revenues, an increase of 65 percent. On November 16, 1983, the Commission suspended the proposed rate increase in order to conduct public hearings and an investigation into the reasonableness of the proposed rates. Since the original filing was incomplete, the suspension period was waived on January 5, 1984, and resumed February 28, 1984. On May 11, 1984, Barbour Manor requested an informal conference to obtain assistance in responding to the Commission's Order dated May 7, 1984. An informal conference was held May 18, 1984, at the offices of the Commission at which time

Barbour Manor was provided necessary clarification of the requirements of the May 7, 1984, Order. A hearing was set for June 4, 1984, and Barbour Manor was directed to give notice to its customers of the proposed rates and the scheduled hearing pursuant to 807 KAR 5:025, Section 7.

Motions to intervene in this matter were filed by the Consumer Protection Division in the Office of the Attorney General ("AG") and a residential customer, Mr. Thomas A. Dieruf.

The hearing was held in the Commission's offices in Frankfort, Kentucky, on June 4, 1984, and all parties of interest were given an opportunity to be heard.

This Order addresses the Commission's findings and determinations on issues presented and disclosed in the hearing and investigation on Barbour Manor's purchase of the assets of Barbour Disposal, financing of the purchase, and the revenue requirements. The Commission has determined herein that Barbour Manor requires an increase in annual revenues of \$7,898.

COMMENTARY

Barbour Manor is a privately-owned utility providing sewage treatment service to 270 residential customers in Jefferson County, Kentucky.

TEST PERIOD

Barbour Manor proposed and the Commission has accepted the 12-month period ending December 31, 1982, as the test period for determining the reasonableness of the proposed rates. In utilizing the historic test period the Commission has given full consideration to appropriate known and measurable changes.

REVENUES AND EXPENSES

For the test period Barbour Manor reported a net operating loss from sewage operations of \$783. Barbour Manor proposed several pro forma adjustments to revenues and expenses to reflect more current and anticipated operating conditions. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

Revenue Normalization

Barbour Manor reported test-year operating revenues of \$29,947. In response to a Commission request to document this level of revenues, Barbour Manor indicated that 13 months, December 1981 through December 1982, were included in this account during the test year. In normalizing test year revenues, the Commission has applied present rates to the number of customers in each rate group, 118 customers at \$7.50 per month and 152 customers at \$10 per month, and finds that the normalized revenue for Barbour Manor is \$28,860.

Utility Service - Water

Barbour Manor reported utility service - water expense in the amount of \$2,200 for the test period. At the Commission's request, Barbour Manor provided copies of its test-year water bills.¹ In reviewing those bills, the Commission found that Barbour Manor was billed in the amount of \$1,697 by Louisville

¹ Response to Commission's Order dated January 3, 1984, Item No. 3.

Water Company for water usage during the test year. Also within this response, Barbour Manor stated that the annual report "appears to be in error by \$502.66."² Therefore, the Commission finds that utility service - water expense was overstated by \$503 on the test-year income statement and has made an adjustment to reduce operation and maintenance expenses by this amount.

Sludge Hauling

In its response to a Commission request for information relative to reported test-year sludge hauling expense of \$1,750, Barbour Manor indicated that it was amending its application to reflect a revised proposed pro forma adjustment to this account based on more current operating information.³ In response to a Commission request to provide support for this revised adjustment, Barbour Manor submitted a calculation indicating that the adjustment was necessary because Metropolitan Sewer District ("MSD") was increasing its dumping fee by \$28.⁴ Also, Barbour Manor indicated that charges of \$12 per load for profit and overhead were being added to the sludge hauling fee resulting in a total adjustment of \$40; from \$120 to \$160 per load. The calculation reflected that CFS Service Company ("CFS") of Louisville, the vendor performing sludge hauling service for Barbour Manor, had previously charged \$86 as a base fee plus \$34

² Ibid.

³ Ibid., Item No. 2.

⁴ Response to Commission's Order dated March 13, 1984, Item No. 1.

for the MSD dumping charge. No evidence has been provided to show that the hauling fee of \$86 per load does not provide sufficient coverage of actual costs for overhead and profit to the sludge hauling company. Since Mr. Carroll Cogan, a principal owner of CFS, is also the owner of Barbour Manor, the Commission finds the acquisition of these services to be a less than arms-length transaction and will therefore disallow the profit and overhead component of this cost. It is the Commission's opinion that Barbour Manor should be allowed to flow through all of the additional costs associated with the increase in the MSD dumping fee; however, the additional charges for overhead and profit are not appropriate for rate-making purposes. It is the Commission's opinion that the current charge of \$120 per load should be increased by \$28 to reflect the higher dumping charge by MSD.

In calculating the annual adjustment, Barbour Manor based its calculation on 21 loads of sludge hauled per year, although only 18 loads were hauled during the test year.⁵ In support of this level of sludge hauling, Barbour Manor submitted invoices indicating that 22 loads were hauled during 1983. The Commission is of the opinion that in this instance 1983 is a better indicator than the test year of the normal level of sludge hauling and the proposed level of 21 loads is not unreasonable for rate-making purposes. Therefore, an adjustment has been made to increase the test-year sludge hauling expense by \$1,358, based on 21 loads at \$148 per load.

⁵ Ibid.

Transportation Expense

Included within Barbour Manor's test-year operation and maintenance expenses are transportation charges in the amount of \$249. In response to a Commission request to document this level of expenditure for transportation, Barbour Manor provided an analysis which indicated that this expense is allocated to Barbour Manor on a pro rata basis.⁶ The analysis indicated that Barbour Manor is allocated a percentage of the total transportation costs of the management of Carroll Cogan Companies ("CCC") equal to the ratio of total sewer connections of Barbour Manor to total sewer connections of all sewer utilities owned by Mr. Cogan. The total transportation costs included lease payments on two vehicles (a Porsche and a van) owned by CCC and the associated operating expenses of gas and oil, etc. No documentation that there were any transportation costs directly related to the operations of Barbour Manor during the test period was provided.

In analyzing the operations of Barbour Manor the Commission found no contractual provisions requiring payments to CCC for any transportation charges. Furthermore, the management contract entered into by Mr. Cogan and Barbour Manor requires Mr. Cogan to,

provide all the normal managerial duties, services and director's assignments as called for in the normal everyday operation of the utility,

⁶ Response to Commission's Order dated January 3, 1984, Exhibit "E".

⁷ Ibid., Exhibit "A".

and makes no mention of additional charges for transportation. For utility managers, the Commission considers travel a normal activity in the everyday operation of a utility.

All other transportation to and from Barbour Manor for sludge hauling, routine maintenance, non-routine maintenance, etc., is either provided for within a monthly fee or billed by vendors on a per mile basis.

The method used by Barbour Manor to calculate transportation expense during the test year does not reflect actual charges for transportation known to have benefited its ratepayers. It is therefore arbitrary and unacceptable for rate-making purposes. Furthermore, no documentation has been provided to indicate that any amounts were chargeable to Account No. 929--Transportation Expense during the test year under the criteria set forth in the Uniform System of Accounts prescribed for Class C and D Sewer Utilities. Therefore, the Commission has made an adjustment to reduce test-year operation and maintenance expense by \$249.

Chemicals Expense

Barbour Manor reported \$1,297 in chemicals expense for the test year.⁸ In support of this level of expenditure Barbour Manor provided the Commission with the invoices for its chemical purchases during the test year. The invoices support the reported test-year chemicals expense; however, further analysis by the Commission revealed that this was an extraordinarily high level of

⁸ Response to Commission's Order dated March 13, 1984, Item No. 13.

expenditure for chemicals in comparison with the years preceding and subsequent to the test year. When asked to provide an explanation for this, Barbour Manor responded that it was "unable to give a specific explanation" for this occurrence and that it "did not manage or operate this system until September 1982."⁹ During 1981, 1982 and 1983, Barbour Manor reported chemicals expense of \$450, \$1,297, and \$311, respectively.

As the basis for several adjustments in this application, Mr. Cogan has used the fact that he did not begin operating the company until the ninth month of the test year and, therefore, 1983 operations should be considered more representative in setting revenue requirements. While it is normal Commission policy to disallow adjustments based on events subsequent to the test year, due to the unusual circumstances in this case, the Commission has allowed and utilized Barbour Manor's proposals that 1983 operations be considered in determining the normal level of certain operation and maintenance expenses. In this instance, the Commission is deviating from normal policy since in 1983, Mr. Cogan operated Barbour Manor the entire year while in 1982, the test year, he did not; and based on historical data the 1983 expense is more reasonable. Therefore, the Commission has reduced chemicals expense by \$986 to reflect this finding.

⁹ Response to Commission's Order dated January 3, 1984, Item No. 5.

Routine Maintenance Service

Barbour Manor reported Routine Maintenance Service expense of \$5,525 during the test year. Apparently, based on reported monthly routine maintenance fees of \$230 by the previous owner and \$400 by the present owner, \$2,085 was erroneously charged to this account during the test year.¹⁰ Barbour Manor proposed no adjustment to include this misclassified expense in another expense account and provided no details of the nature of the expense.

An adjustment was proposed to increase the monthly fee from \$400 to \$450 per month or \$5,400 annually. In support of this adjustment, Barbour Manor filed a letter from the service company providing the routine maintenance, Andriot-Davidson's Service Company, Inc., ("Andriot-Davidson"), a company also owned by Mr. Cogan, which reflected the increase.¹¹ In considering this adjustment the Commission determined that transactions between Barbour Manor and Andriot-Davidson, because of their mutual ownership, are not at arms-length and, therefore, the burden of proof is on Barbour Manor to demonstrate that the monthly charge for routine maintenance service is fair, just and reasonable. Barbour Manor was put on notice to that effect and the

10	8 months @ \$230	\$1,840
	4 months @ \$400	1,600
	Actual Test Year	<u>\$3,440</u>
	Reported Test Year	5,525
	Misclassified	<u>\$2,085</u>

11 Ibid., Exhibit "C".

Commission requested information necessary to make a decision on this matter.¹² Upon receipt of an incomplete response to this request, the Commission again requested the information it deemed necessary to determine the reasonableness of the proposed charges. Again, Barbour Manor failed to provide a complete response to the request.¹³

In support of the adjustment, Barbour Manor provided bids from several operators to provide routine maintenance service for Barbour Manor and other sewer utilities owned by Mr. Cogan. However, the bids submitted by Barbour Manor provided no detail as to what services were to be provided by the several operators, so a comparison of the prices could not be made. When informed of this lack of comparative information, Barbour Manor suggested that it was industry practice to contract for routine maintenance on the basis of an understanding that the plant will be operated at a level which will meet health department standards.

It is the Commission's opinion that Barbour Manor has not met its burden of proof on this issue and the adjustment from \$400 to \$450 per month should not be allowed for rate-making purposes in this case. Therefore, the Commission has made an adjustment to reduce the reported test year expense of \$5,525 by \$725 which reflects a routine maintenance fee of \$400 per month, or \$4,800 annually.

¹² Response to Commission's Order dated March 13, 1984, Item No. 14.

¹³ Response to Commission's Order dated May 7, 1984, Item No. 2.

Maintenance of Treatment and Disposal Plant/Depreciation

Barbour Manor reported Maintenance of Treatment and Disposal Plant expense of \$3,191 for the test period; however, a significant portion of that amount should have been capitalized to plant in service accounts. An adjustment was proposed to increase this expense to an adjusted level of \$5,000. Barbour Manor used 1983 maintenance expense as a basis for the proposed adjustment.¹⁴ The Maintenance of Treatment and Disposal Plant expense reported for 1983 was \$6,518. The Commission agrees that in this instance the normal annual level of expense in this particular account is better represented by the 1983 operations. This finding is based on the fact that the new owner, Mr. Cogan, operated Barbour Manor for only 4 months of the test year, whereas the entire year ending December 31, 1983, was under the new ownership.

In support of its proposed adjustment, Barbour Manor filed copies of 1983 maintenance invoices.¹⁵ Upon examination of these invoices the Commission found that approximately \$6,000 of the amount charged to this account during the test year was paid to Andriot-Davidson. Since these transactions were at less than arms-length, the Commission attempted to make a detailed investigation to determine if the transactions were fair, just and reasonable. The Commission requested information relevant to the operations of Andriot-Davidson in order to obtain evidence that

¹⁴ Response to Commission's Order dated January 3, 1984, Item No. 7.

¹⁵ Ibid.

the transactions between these two affiliated companies are reasonable.¹⁶ However, this information was not provided on the grounds that Andriot-Davidson is a non-regulated entity. Therefore, the Commission makes no finding herein as to whether the transactions between Andriot-Davidson and Barbour Manor are reasonable and transactions between these affiliated companies will continue to be closely scrutinized in future proceedings.

Upon further examination of invoices charged to Maintenance of Treatment and Disposal Plant, it was determined that a significant portion of the 1983 expenditures should have been capitalized. Upon cross-examination at the June 4, 1984, hearing, Mr. Cogan could not provide evidence that these items should not be capitalized.¹⁷ Therefore, the Commission finds that the following expenditures should be capitalized to Utility Plant in Service:

<u>Invoice</u>	<u>Job</u>	<u>Amount</u>	<u>Account No.</u>	<u>Account</u>
720-4	6/1/83	\$ 603	373	Treatment & Disp. Equip.
720-4	7/14/83	752	373	Treatment & Disp. Equip.
519-3	4/19/83	536	373	Treatment & Disp. Equip.
1018-11	10/18/83	767	373	Treatment & Disp. Equip.
131-1	1/31/83	246	373	Treatment & Disp. Equip.
Grover Equip.	8/83	<u>576</u>	373	Treatment & Disp. Equip.
Total		<u><u>\$3,480</u></u>		

¹⁶ Responses to Commission's Order dated March 13, 1984, Item No. 7, and Commission's Order dated May 7, 1984, Item No. 1.

¹⁷ Transcript of Evidence, June 4, 1984, pp. 106-107.

The Commission, therefore, has made an adjustment to reduce Maintenance of Treatment and Disposal Plant by \$3,480. Furthermore, the Commission is of the opinion that the full amount capitalized should be depreciated over 3 years, which results in an adjustment to increase depreciation expense by \$1,160.¹⁸

Amortization of Plant Acquisition Adjustment

Barbour Manor proposed to increase operating expenses by \$3,750 to reflect the annual amortization of the plant acquisition adjustment of \$37,850 over a 10-year period. In support of its position on this issue, Barbour Manor submitted the testimony of Mr. M. Dell Coleman, a utility rate consultant. The testimony of Mr. Coleman cited several cases in other regulatory jurisdictions where the amortization of plant acquisition adjustments is allowed for rate-making purposes. Those cases were similar in that the basic issue was the amortization of the acquisition adjustment for rate-making purposes; however, in those cases it was not apparent that the plant which was transferred had been recovered by the previous owner through contributions in aid of construction.

This Commission has a well established policy in recent sewage utility cases of disallowance of the amortization of plant acquisition adjustments where the purchase price is in excess of the depreciated original cost less contributions in aid of construction. The basis for the Commission's position on this issue is that to allow the amortization of the plant acquisition

¹⁸ Plant Capitalized
Depreciation Rate
Depreciation Expense

\$3,480
33.3%

\$1,160

adjustment would require the ratepayers of the utility to pay for the same plant twice. The Commission finds no evidence in this case that would lead it to alter its opinion on this issue. Therefore, no adjustment has been made herein to reflect the amortization of the plant acquisition adjustment for rate-making purposes.

Interest Expense

Barbour Manor proposed an adjustment of \$3,780 to include the interest associated with the purchase of the assets of Barbour Utilities. The former owner of Barbour Disposal, Mr. C. Robert Peters, Jr., is financing the purchase at an interest rate of 10 percent over a 10-year period. Because Mr. Cogan executed his purchase in the name of Barbour Manor, the purchase price is reflected in accordance with generally accepted accounting principles as a liability on the books of Barbour Manor.

The Commission is of the opinion that inasmuch as the amortization of the plant acquisition adjustment has not been allowed herein, it is likewise inappropriate to include the interest expense and principle repayment on the loan obtained to finance the purchase. Therefore, the proposed adjustment to interest expense has not been included for rate-making purposes herein.

After consideration of the aforementioned adjustments, the Commission finds Barbour Manor's adjusted test period operations to be as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$29,947	\$<1,087>	\$28,860
Operating Expenses	31,730	<425>	31,305
Net Operating Income	<1,783>	<662>	<2,445>
Other Income	1,000	<1,000>	-0-
Net Income	<u>\$ <783></u>	<u>\$<1,662></u>	<u>\$<2,445></u>

REVENUE REQUIREMENTS

Barbour Manor based its requested increase in revenue on an operating ratio methodology and requested revenue sufficient to produce a ratio of .88. In order to achieve this ratio, Barbour Manor should be allowed to increase its annual revenue by \$7,898, an increase of 27 percent. This additional revenue, after the provision for income taxes of \$1,060, will provide total revenues of \$36,778 and net income of \$4,413.

RATE DESIGN

Barbour Manor presently has two classifications in its rate design; however, both are single family residential. Barbour Manor has proposed to change the rate design by combining the two classifications and have a single rate for all single family residential customers. The Commission is of the opinion that the proposal is fair, just and reasonable and should be allowed.

SUMMARY

The Commission, having considered the evidence of record and being advised, is of the opinion and finds that:

1. The rate in Appendix A is the fair, just and reasonable rate for Barbour Manor and will produce gross annual revenue

sufficient to pay its operating expenses and provide a reasonable surplus for equity growth.

2. The rate proposed by Barbour Manor would produce revenue in excess of that found to be reasonable herein and therefore should be denied upon application of KRS 278.030.

3. The change in rate design proposed by Barbour Manor is fair, just and reasonable and should be allowed.

4. The present operator, Barbour Manor, is ready, willing and able to purchase, operate and provide adequate and reliable service to the customers formerly served by Barbour Disposal. Furthermore, the stockholders of Barbour Disposal are ready and willing and they desire to sell, inasmuch as they wish to divest themselves of the ownership and operation of this sewage treatment system.

5. The quality of service to the present customers of Barbour Disposal will not suffer in that Andriot-Davidson, which has knowledge and experience in the operation and maintenance of sewage treatment facilities, will be employed to operate the system. Furthermore, Andriot-Davidson is familiar with the construction and operation of this treatment plant.

6. Barbour Manor has indicated that if the Commission does not allow the amortization of the acquisition adjustment and interest charges on the loan to finance the acquisition for rate-making purposes, eventually Barbour Manor would no longer be an economically viable entity. As delineated herein, the Commission will not allow these costs for rate-making purposes and makes its finding that the transfer should be approved with the condition

that if necessary Mr. Cogan will inject equity capital into Barbour Manor to keep it financially viable, in the event other capital is not available at a reasonable cost.

7. The agreed-upon purchase price is \$37,850 which was determined through negotiations between the stockholder of Barbour Manor and the stockholder of Barbour Disposal.

8. Barbour Manor has filed with the Commission its Articles of Incorporation.

9. Barbour Manor should maintain its books of account in accordance with the Uniform System of Accounts for Sewer Utilities prescribed by this Commission. Accounting for an acquisition includes:

a. Recording the utility plant acquired at its original cost to the person first devoting it to public service, estimated if not known, in the appropriate utility plant in service accounts;

b. Crediting the requirements for accumulated provision for depreciation and amortization applicable to the original cost of the properties acquired to the appropriate account for accumulated provision for depreciation and amortization;

c. Transferring the cost of any nonutility property to Account No. 121--Nonutility Property;

d. Crediting contributions in aid of construction, estimated if not known, to Account No. 271--Contributions in Aid of Construction; and

e. Including in Account No. 108--Utility Plant Acquisition Adjustment, any difference between the purchase price and the original cost of the utility plant and nonutility property less the amounts credited to accumulated depreciation and amortization reserves and contributions in aid of construction.

10. While legal and proper for general accounting purposes, this acquisition transaction, if not at "book value", can either increase or decrease the debt and/or equity on the utility's books. Therefore, Barbour Manor and its stockholders are hereby apprised that the Commission will not allow, for rate-making purposes, interest charges on debt that exceed those charges which would have been incurred to finance the original cost of plant in service excluding any acquisition adjustment less accumulated depreciation and contributions in aid of construction. Allowable interest charges should be computed using the weighted average cost of debt. The Commission also will not allow a return on equity or amortization of an acquisition adjustment that resulted from this transaction for rate-making purposes.

11. Barbour Manor, in its amended application, requested authority to borrow \$37,850 to finance the purchase of the assets of Barbour Disposal. The purchase price is being financed by Mr. Peters, owner of Barbour Disposal, with the purchase price payable over 10 years with interest at the rate of 10 percent per annum on the unpaid balance. The financing of \$37,850 by Mr. Peters to Barbour Manor should be approved. However, since the ownership of Barbour Manor and not the ratepayers is the beneficiary of the purchase, it shall be responsible for the retirement of said debt.

IT IS THEREFORE ORDERED that the rate design shall be changed as proposed and the rate contained in Appendix A is hereby approved for services rendered by Barbour Manor on and after the date of this Order.

IT IS FURTHER ORDERED that the rate proposed by Barbour Manor be and it hereby is denied.

IT IS FURTHER ORDERED that the transfer of Barbour Disposal from its stockholder, Mr. C. Robert Peters, Jr., to Barbour Manor and its stockholder, Mr. Carroll F. Cogan, be and it hereby is approved subject to conditions set out in Finding No. 6.

IT IS FURTHER ORDERED that the financing of \$37,850 as described in Finding No. 12 be and it hereby is approved.

IT IS FURTHER ORDERED that in future rate cases the allowable interest charges for the purposes of setting rates shall be determined as set out in Finding No. 11.

IT IS FURTHER ORDERED that Barbour Manor shall make the necessary adjustments to its records in the areas specified herein in order to be in compliance with Commission regulations.

IT IS FURTHER ORDERED that Barbour Manor shall adjust its accounting practices to conform to the Uniform System of Accounts for Sewer Utilities.

IT IS FURTHER ORDERED that within 30 days from the date of this Order Barbour Manor shall file with this Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 5th day of July, 1984.

PUBLIC SERVICE COMMISSION

Richard D. Hermann
Chairman

Rich. D. Hermann
Vice Chairman

Sam Shull
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 8933 DATED July 5, 1984.

The following rate is prescribed for customers in the area served by Barbour Manor Utilities, Inc., located in Jefferson County, Kentucky. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

RATES: Monthly

Single Family Residential	\$11.35
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